In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 91

58TH STREET PLAZA THEATRE, INC., and JEANNETTE BRECHER, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 106-118) are reported at 16 T.C. 469. The majority and dissenting opinions of the Court of Appeals (R. 139-144) are reported at 195 F. 2d 724.

JURISDICTION

The judgments of the Court of Appeals were entered on March 18, 1952. (R. 144, 145.) The petition for a writ of certiorari was filed on May

29, 1952. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's conclusion that the subleasing arrangement between taxpayer 58th Street Plaza Theatre, Inc., and taxpayer Jeannette Brecher had no business purpose and was but a family arrangement for distribution of income of the corporation to Jeannette Brecher and, accordingly, did not relieve the corporation of tax on the net profit derived from the operation of the theatre in 1943 under Jeannette Brecher's name.[1]

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or per-

[1] Subsidiary questions, not separately presented in the petition, are whether the court below erred in affirming the Tax Court's holding that the net profit received from the operation of the theatre by Jeannette Brecher, a stockholder of Plaza, is taxable to her as a dividend and whether taxpayer Jeannette Brecher is entitled to an earned income credit of $1,500.

sonal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

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(26 U.S.C. 1946 ed., Sec. 22.)

STATEMENT

The pertinent facts found by the Tax Court from a stipulation of facts, exhibits, and oral testimony (R. 108-112) are as follows:

Taxpayer 58th Street Plaza Theatre, Inc. (hereinafter called "Plaza"), is a corporation organized and existing under the laws of the State of New York. It used the accrual method of accounting. Taxpayer Jeannette Brecher is the wife of Leo Brecher. They filed their returns on a cash basis. For 1942 they filed a joint return and for 1943 individual returns. (R. 108.)

Leo Brecher has been engaged successfully for a long time in the motion picture industry as an exhibitor operating, owning or leasing motion picture theatres in New York and vicinity. He leased property on 58th Street near Madison Avenue in New York in 1929 and converted the existing stables on the property into a motion picture theatre, expending approximately $125,000 of his own funds for that purpose. He called it

the Plaza Theatre. The current lease runs for a term of 20 years commencing September 1, 1939. The rental is $30,000 a year, 15 percent of annual box office receipts in excess of $225,000, plus all taxes on the property in excess of $7,500 per annum. (R. 109.)

Plaza occupied and operated the theatre commencing September 1, 1939, under an oral agreement with Brecher for tenancy from month to month terminable at will. That arrangement continued until February 28, 1942, on which date Brecher sold the lease to Plaza for $200,000. (R. 110.)

On December 29, 1942, Brecher owned 1,050 shares, Jeannette Brecher owned 425 shares, their son owned 250 shares and their daughter owned 250 shares of the stock of Plaza. The children received their shares as gifts from Brecher. (R. 110.)

On December 29, 1942, Plaza subleased the theatre to taxpayer Jeannette Brecher for a term of five years commencing January 1, 1943, with provision for renewals. Under the sublease (Ex. 12-L) she was required to pay a fixed rental of $40,000, 15 percent of the amount by which the box office receipts exceeded $225,000 in each year, $15,000 per annum out of the profits from the operation of the theatre, and all taxes on the property in excess of $7,500 a year. The lessor could cancel the lease if less than $20,000 was paid

out of the profits in any two consecutive years. The owner of the property was not informed of the sublease. (R. 110-111.)

Jeannette Brecher opened a bank account in her registered trade name, "58th Street Plaza Theatre Company", through which she put the receipts and disbursements of the theatre. Brecher and Frank Schiffman, employed by Brecher, were authorized to draw checks on the account. Jeannette Brecher was issued a license by the City of New York to operate the theatre and the license previously issued to Plaza was cancelled. The insurance policies of the theatre were transferred to Jeannette Brecher. Contracts for films were entered into in her trade name after January 1, 1943, and she in other ways held herself out as operator of the theatre. (R. 111.)

Jeannette Brecher employed Brecher to manage the theatre for her during 1943 at a salary of $6,000 per year. She was present at the theatre on three or four days each week for periods varying from one to three hours. She paid the rent to Plaza for 1943 as required by the sublease. (R. 111.)

Jeannette Brecher reported a net profit from the operation of the theatre of $40,096.64 in her return for 1943. No part of that income was ever received by Brecher, directly or indirectly, and no part of it was used to discharge any of his obligations. Jeannette Brecher was not limited in any

way in the use of the income which she derived from the operation of the theatre. She used a large part to pay federal and state income taxes and used other parts for personal purposes. (R. 111.)

The Commissioner, in determining deficiencies, held that $40,396.34 was additional income of Plaza, on the ground that the sublease from Plaza to Jeannette Brecher did not constitute a bona fide transaction, and that $40,096.64 was taxable to her as a dividend from Plaza.[2] (R. 111-112.)

Jeannette Brecher gave 400 of her 425 shares of Plaza stock to her children on January 4, 1943. (R. 112.)

The box office receipts for the theatre ranged from a high of about $274,000 in 1931 to a low of about $146,000 in 1939. They amounted to about $180,000 in 1942 and to about $239,000 in 1943. The operating profit from the theatre ranged from a high of about $92,000 in 1931 to a low of about $2,800 in 1939. Plaza reported net income of $16,284 for 1942 from the operation of two theatres, of which Plaza was the more profitable. (R. 112.)

The sublease from Plaza to Jeannette Brecher, the Tax Court specifically found, served no business purpose of Plaza but was a family arrange-

[2] As the Tax Court stated (fn., R. 111), why the Commissioner included the extra $300 over the amount reported by Jeannette Brecher is not shown.

ment to give Jeannette Brecher increased income at the expense of Plaza and without payment of taxes thereon by Plaza. (R. 112.)

The Tax Court accordingly held that the 1943 net profits from the operation of the Plaza Theatre constituted taxable income of Plaza and, having been received by Jeannette Brecher, a stockholder of Plaza, were taxable to her as a dividend. (R. 114-117.) The Court of Appeals affirmed (R. 139-143), with one judge dissenting (R. 143-144).

ARGUMENT

Taxpayers incorrectly assert that the decision below presents an important question, is in conflict with a number of decisions of other Courts of Appeals, and is inconsistent in principle, and probably in conflict, with decisions of this Court. (Pet. 7-8.) The petition states no adequate ground for the granting of a writ of certiorari.

1. No important question is presented. The basic question is simply whether the subleasing transaction between the family-corporation taxpayer, Plaza, and taxpayer Jeannette Brecher, a stockholder, must be given effect for tax purposes. It is axiomatic that in tax law substance rather than form controls,[3] that family arrangements are particularly subject to careful scrutiny,[4] and that

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[3] See, e.g., *Higgins* v. *Smith*, 308 U.S. 473; *Commissioner* v. *Court Holding Co.*, 324 U.S. 331.

[4] *Commissioner* v. *Tower*, 327 U.S. 280, 291; *Commissioner* v. *Culbertson*, 337 U.S. 733, 746.

a transaction or arrangement which is unreal or a sham may be disregarded.[5] The case therefore involves only an application of well-settled principles to the facts of the case. On the facts, both the Tax Court and the court below, the latter with one judge dissenting, regarded the subleasing transaction as unreal (R. 114-117, 140-143), the court below classifying it as an arrangement which can be called a sham or any one of a number of similar names (R. 140).[6] Taxpayers are incorrect in intimating (Pet. 14) that the court below held the arrangement to be a sham merely because it effected tax savings. The decision was based on all the facts and primarily upon the lack of a business purpose for a transaction which purported to be a business transaction. (See R. 140-141.) The decision below not only is correct, we submit, but presents a question which has no im-

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[5] See, e.g., *Higgins* v. *Smith, supra; Gregory* v. *Helvering*, 293 U.S. 465; *Bazley* v. *Commissioner*, 331 U.S. 737; *Stanwick's, Inc.* v. *Commissioner*, 15 T.C. 556, affirmed *per curiam* for reasons adequately stated in the opinion of the Tax Court, 190 F. 2d 84 (C.A. 4th); *W. H. Armston Co.* v. *Commissioner*, 188 F. 2d 531 (C.A. 5th); *Ingle Coal Corp.* v. *Commissioner*, 174 F. 2d 569 (C.A. 7th); *Limericks, Inc.* v. *Commissioner*, 165 F. 2d 483 (C.A. 5th); *Home Furniture Co.* v. *Commissioner*, 168 F. 2d 312 (C.A. 4th); *Palace Theatre* v. *United States*, 148 F. 2d 30 (C.A. 7th).

[6] The Tax Court specifically found as a fact that the subleasing arrangement served no business purpose of Plaza and was but a family arrangement to give Jeannette Brecher increased income at the expense of Plaza and without payment of taxes thereon by Plaza. (R. 112.)

portance in connection with other cases, which must necessarily be decided on their own facts.

2. The alleged conflict between the decision below and decisions and views of other circuits (Pet. 8-15) is non-existent.

The cases relied upon by taxpayer for a direct conflict are simply cases in which, with different facts, different results were reached. The present case involves a subleasing transaction, between a family corporation and one of the family stockholders, which was ostensibly a business transaction but which lacked a business purpose, was not an arm's length transaction, and was bad business for the corporation. Of the three decisions with which taxpayers allege the decision below is in conflict, only one involved a transaction between a corporation and a stockholder or stockholders. In *L. W. Tilden, Inc.* v. *Commissioner,* 192 F. 2d 704 (C. A. 5th), the taxpayer-corporation leased, for a fair rental, its citrus groves to a joint venture composed of stockholders. The Fifth Circuit stated that the corporation and its stockholders had a right to change the manner of operating the groves-"But any change must have a business and not merely a tax-saving purpose" (p. 708). The holding that the joint venture was real and not a sham rested primarily upon a conclusion that the joint venture was in accord with and carried out "the prime and unceasing purpose and intention which had dominated the Tilden

operations from the beginning", which was "to discharge the heavy indebtedness which had accumulated against the Tilden properties and to save them for their real owners, the members of the Tilden family" (p. 709). *Henson* v. *Commissioner,* 174 F. 2d 846 (C.A. 5th), involved a gift of a business from husband to wife, rather than a purported business transaction. *Goold* v. *Commissioner,* 182 F. 2d 573 (C.A. 9th), involved the question whether the income from a partnership interest was the taxpayer's separate property, taxable entirely to him, or was community property. It was his separate property only if he had received the partnership interest from his father by gift rather than by sale. The father had purported to make a sale of the partnership interest to him and there was in the case no tax avoidance purpose or other reason for holding that the purported sale was intended to be a gift.[7]

Taxpayers' assertion of a conflict between the

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[7] As taxpayers urge by citing and quoting other decisions (Pet. 9-11, 11-12), a tax avoidance motive does not *per se* require that a transaction be disregarded for tax purposes. The question is still whether the transaction has substance and reality. But in that connection the tax avoidance motive may properly be considered (*Commissioner* v. *Tower,* 327 U.S. 280, 288-289) and in some circumstances the lack of any other purpose, such as a business purpose in a business transaction, will reflect the lack of substance in the transaction. The converse may also be true; that is, as in the *Goold* case, *supra,* the lack of a tax avoidance motive may reflect bona fide intent.

decision below and the "views" of other circuits (Pet. 12-14) is also based upon cases which are factually distinguishable. In *John L. Denning & Co.* v. *Commissioner,* 180 F. 2d 288 (C.A. 10th), where a partnership was formed to carry on the same business which had been and continued to be carried on by a corporation, the question was whether the separate identity of the partnership should be recognized. The Tenth Circuit held that it should be, stating that the undisputed facts showed, among other things, that the partnership served an independent and legitimate business purpose. *Greenberger* v. *Commissioner,* 177 F. 2d 990 (C.A. 7th), held that a valid family partnership existed for tax purposes because the facts showed the good faith and legitimate purpose of the parties in forming the partnership. In *Brown* v. *Commissioner,* 180 F. 2d 926 (C.A. 3d), certiorari denied, 340 U.S. 814, the question, answered in the affirmative by the Third Circuit, was whether husband and wife, partners in a business, were entitled to business expense deductions for rents and royalties they paid as a result of their gift in trust and leaseback arrangement.[8]

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[8] The following cases, cited by taxpayers as "See also" cases (Pet. 13, 14), are all also distinguishable from the present case on their facts: *Visintainer* v. *Commissioner,* 187 F. 2d 519 (C.A. 10th), certiorari denied, 342 U.S. 858 (which involved a gift rather than a business transaction); *Wellington* v. *Commissioner* (C.A. 7th), decided May 13, 1952 (1952 P-H par. 72,443) (a family partnership case); *Skemp* v.

3. The decision below is not inconsistent or in conflict with *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451. What the Court held in that case was that a sale of corporate assets by the stockholders following a genuine liquidation and dissolution of the corporation would not be attributed to the corporation merely because of the stockholders' tax avoidance motive, Congress having chosen, for tax purposes, to recognize a distinction between a sale by the corporation and a sale by the stockholders following a genuine liquidation. Taxpayers apparently interpret the decision as holding that a tax avoidance motive may not be considered in connection with any tax situation or question. (See Pet. 15.) The decision does not so hold.

Taxpayers' assertion that the decision below misconstrues *Gregory* v. *Helvering*, 293 U.S. 465, is based on the erroneous assumption that the court below cited that decision "for the proposition that the income of Jeannette Brecher from the operation of the theatre under the sublease may be taxed to Plaza because the Tax Court found that the sublease was motivated by pros-

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Commissioner, 168 F. 2d 598 (C.A. 7th) (involving the question whether the taxpayer was entitled to a business expense deduction for rent paid pursuant to a gift and leaseback arrangement); *Funai* v. *Commissioner*, 181 F. 2d 890 (C.A. 4th) (a family partnership case); and *Stanchfield* v. *Commissioner*, 191 F. 2d 826 (C.A. 8th) (a family partnership case).

pective tax savings." (Pet. 15-16.) The Court below used the *Gregory* decision only as a general expression of the "applicable doctrine" that a purported business arrangement which serves no business purpose does not succeed as an insulator of the corporation from tax liability—that in keeping with the decisions such an arrangement may be treated as a sham. (R. 140.) It was that doctrine which the court below applied to the facts of the case, not, as taxpayers intimate (Pet. 16), the theory that a tax avoidance motive *per se* requires that a transaction be disregarded. In applying the doctrine, the court below considered not just taxpayers' tax avoidance motive but all of the other facts, notably, that there was no business purpose, that the subleasing transaction was not at arm's length, and that the transaction was bad business for the corporation. (See R. 141-142.)

CONCLUSION

The decision below is correct and involves no conflict of decisions or important question. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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58TH STREET PLAZA THEATRE, INC., and JEANNETTE BRECHER,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING — PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR REHEARING—PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, 58th Street Plaza Theatre, Inc., and Jeannette Brecher, present this, their petition, for a rehearing of the above-entitled cause, and, upon such rehearing, respectfully request this Honorable Court to issue writs of certiorari to the United States Court of Appeals for the Second Circuit to review the decision and judgments of that court entered pursuant to the majority opinion affirming the decision and orders of The Tax Court of the United States. In support hereof, petitioners respectfully show:

I.

On May 29, 1952, petitioners filed a petition for writs of certiorari to the United States Court of Appeals for the Second Circuit, seeking review of the decision and judgments of that court entered on March 18, 1952, reported at 195 F. 2d 724, affirming 16 T. C. 469 (opinion by Judge Murdock, not reviewed by the court).

II.

Subsequent to the decision of the instant cause on February 27, 1951 by the Tax Court, and after the time in which to apply to that tribunal for rehearing or reconsideration had expired, another case involving the same question presented by the petition for writs of certiorari herein was considered by the Tax Court which then announced conclusions the exact opposite of those held controlling in this proceeding. *Coca-Cola Bottling Co. of Sacramento, Ltd., et al.* v. *Commissioner*, 17 T. C. 101, decided July 31, 1951. The latter decision was reviewed and approved, except for one dissent, by the full court.

III.

The issue in this proceeding is whether a split-off of business property must be in the best interests of the corporate transferor. The Tax Court found that a certain transfer (sublease) of a theatre by a closely held corporation to the wife of the majority stockholder was consummated, that the theatre business was carried on by or for the account of the transferee, and that the transferee received and used the net income for her own purposes. The trial

judge, however, applied the so-called "business purpose" doctrine and held that the transfer might be disregarded by respondent because it served no business purpose of the corporation.

IV.

In the *Coca-Cola Bottling Company* case, *supra*, the Tax Court considered the Commissioner's contention that a transfer (sublicense) by a closely held corporation to a partnership consisting of its two principal stockholders (husband and wife) served no business purpose of the corporation, that the partnership was therefore a sham, and that such transfer was merely a device for reallocating income among the family group with resulting tax advantage. There, however, the court pointed out that the parties intended to form the partnership to take over the business from the corporation and that the business was actually operated thereafter by the partnership. Accordingly, the court overruled the Commissioner, stating that a taxpayer has the right to adopt the type of organization which he prefers for the conduct of business.

V.

The facts in the *Coca-Cola* case closely parallel those in this proceeding; the issue involved is the same. As stated in the dissenting opinion of Judge Swan of the Second Circuit, the instant parties both intended and carried out the change from corporate to individual operation in accordance with the sublease, which created valid legal relations. Moreover, the Tax Court cited as authority for its conclusions in the *Coca-Cola* case, two of the very decisions of the Circuit Courts of Appeal which had reversed the

Tax Court's own earlier contrary decisions, promulgated while it was still maintaining, consistent with Judge Murdock's decision in this proceeding, that the Commissioner need not respect such transactions among related taxpayers. *Twin Oaks Co.* v. *Commissioner*, 183 F. 2d 385, CA-9, reversing 8 TCM 280; *John L. Denning & Co., Inc.* v. *Commissioner*, 180 F. 2d 288, CA-10, reversing 7 TCM 980.

VI.

Subsequent to the filing of the petition for writs of certiorari herein on May 29, 1952, and subsequent to the filing of the respondent's brief in opposition, the respondent formally acquiesced in the decision of the Tax Court in the *Coca-Cola Bottling Company* case, *supra* (Internal Revenue Bulletin of September 1, 1952, 1952-18-13908). By such acquiescence, respondent has accepted the decision as correct and has authorized administrative officials of the Bureau of Internal Revenue to apply the principles thus established in all other cases.

VII.

The instant petition for writs of certiorari was denied by this Court on October 13, 1952. However, now that the Tax Court, with only one dissenting judge, has reversed its position to accord with that of the great majority of the Circuit Courts of Appeal (the Second Circuit alone is squarely opposed), the instant case should be disposed of consistent with what is now the official view. Unless this Court acts, it will be impossible for petitioners to obtain the same treatment now concededly due to all taxpayers alike.

Wherefore, upon the foregoing grounds and in order that petitioners' cause may be disposed of in accordance

with the principles now formally acknowledged by respondent as correct, it is respectfully urged that this petition for a rehearing be granted, that the Court issue writs of certiorari to the United States Court of Appeals for the Second Circuit, and that, upon the issuance of such writs, the cause be reviewed by this Honorable Court, or remanded with instructions to the end that the decision and judgments shall be reviewed by the courts below and modified in conformity with principles now adopted by respondent for the administration of the revenue laws.

Respectfully submitted,

PAUL R. RUSSELL,
HOWARD D. PACK,
Counsel for Petitioners.

Certificate of Counsel.

We, counsel for the above-named petitioners, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

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